MCI

November 23, 2004

BY ELECTRONIC FILING

Marlene H. Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: Written *Ex Parte* Presentation, *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* WC Docket No. 04-313, CC Docket No. 01-338

Dear Ms. Dortch:

On November 16, 2004, Verizon filed an *ex parte* letter in this docket, attaching a recent filing by MCI in a California state regulatory proceeding. As Verizon expressly acknowledges, MCI's pleading was submitted in response to a request by the California Public Utilities Commission "for comment on whether it should revise *traditional retail regulation* of ILECs."[1] Verizon contends that this filing amounts to an admission by MCI "that the arguments it advanced in this proceeding no longer are valid"[2] – a claim that misstates the facts and ignores the context in which the California pleading was filed.

Even a cursory review of the MCI submission shows that MCI did not contradict the facts or contentions that it has advanced in this proceeding concerning the state of intermodal competition. More fundamentally, the California proceeding and this Commission's pending *Triennial Remand* proceeding involve very different issues. The California Public Utilities Commission is examining in two concurrent proceedings the *retail regulatory framework* applicable to the state's foremost ILECs, and the *application of intrastate switched access charges*. In the instant proceeding, the FCC is charged with examining *impairment in the absence of the availability of*

1 Letter from Dee May, Verizon, to Marlene H. Dortch, FCC, WC Docket No. 04-313, at 1 (Nov. 16, 2004) (emphasis added).

2 *Id.*

unbundled network elements – focusing on the importance of wholesale offerings.[3]

The retail competition that MCI discusses in its California proceeding – cable, VoIP, and wireless – is relevant to the manner in which the California Public Utilities Commission regulates the retail telecommunications market and to the effects on competition of overpriced intrastate switched access charges. But as MCI has already explained in its written filings in this proceeding, the presence of cable, VoIP, and wireless does not eliminate impairment with respect to unbundled mass market switching.

<u>The California Proceeding</u>

In the California matter, MCI commented that:

> recent technological, regulatory, and market changes require a fundamental reevaluation of *retail* regulation of traditional wireline telecommunications firms. Where market conditions justify, such as in the *retail* market, regulation should be relaxed or eliminated, both for the ILECs and for competitive local exchange carriers. *But deregulation where deregulation is merited must go hand in hand with continued regulation where monopoly conditions persist, in wholesale markets such as for unbundled network elements and switched access.*[4]

Contrary to Verizon's claims, MCI did not counter or otherwise "admit" to the invalidity of any of the arguments made in this proceeding concerning impairment in the absence of unbundled switching. Rather, MCI argued that:

> [The ILECs] want deregulation on the retail side but want the guaranteed revenue streams that current regulations provide, such as the current intrastate switched access charge regime. The Commission should recognize market developments and free the ILECs from the unnecessary burdens of retail regulation, but only if at the same time it eliminates the

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[3] MCI's California pleading specifically noted what is obvious and known to Verizon – that because wholesale regulation of incumbent LECs pursuant to Sections 251 and 252 of the Communications Act, 47 U.S.C. §§ 251-252, was well beyond the scope of the state proceeding in which the pleading was filed, matters relating to such issues were not addressed. MCI's Opening Comments at 4 n.3, *Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Inc.*, Rulemaking 01-09-001 (California Public Utilities Commission) (filed Nov. 4, 2004).

[4] *See* MCI's Reply Comments at 1, *Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Inc.*, Rulemaking 01-09-001 (California Public Utilities Commission) (filed Nov. 15, 2004) (emphasis added) (attached as Exhibit 1).

> benefits of regulation that are no longer warranted and afford the ILECs unequal protection and competitive advantage. This means that any ILEC deregulation should be tied to a reduction in switched access charges to cost based levels. Further, as MCI set out in its opening comments retail deregulation should apply equally to all wireline carriers, ILECs and competitive local exchange carriers alike.[5]

Viewed in context, it is clear that MCI's California pleading has nothing to do with impairment issues and instead is focused on eliminating the unnecessary burdens of retail regulation for ILECs and CLECs alike while also eliminating the unwarranted benefits of the current state regulatory scheme, such as bloated intrastate access charges.

Impairment and Intermodal Competition

The coming expected convergence of voice and data, and the growing participation of nontraditional firms engaged in competition with traditional service providers at the retail level, are well known phenomena that can and will have a significant impact on retail regulation, and in particular the application of intercarrier charges. However, these developments reveal little or nothing, in and of themselves, about whether requesting carriers are impaired in the absence of nondiscriminatory access to specific unbundled network elements.

Cable company offerings: It is a fact, as the California pleading indicates, that some cable companies in California now offer some form of telephony services in retail competition to services offered by MCI *within the cable companies' franchise territories*. Entry by cable companies within their franchised territories using their own loop and switching facilities, however, is not evidence of actual deployment of the type that would lead to the conclusion that requesting carriers are not impaired without unbundled access to incumbent LEC switching, for the following reasons:

- Cable companies do not utilize the ILEC's loop plant to provide service and therefore do not require hot cuts to migrate customers. No other carrier can duplicate this entry strategy.
- Packet-switched cable telephony services (like other VoIP services) are subject to significant limitations on 911 dialing, and do not have access to backup power in emergencies.
- Packet-switched cable telephony requires the purchase of cable modem service, which renders its cost significantly higher than the cost of ILEC landline voice service.[6]

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5 *Id.* at 1-2.

6 *See generally* MCI Comments, WC Docket No. 04-313, at 93-98 (Oct. 4, 2004).

Moreover, even if the Commission were to conclude that cable telephony is a viable substitute for ILEC local service, where available, that would leave the majority of Californians with no choice at all.[7] Even for the one-third of Californians with a choice of DSL or cable modem services, the result would be a duopoly, not a competitive marketplace.

VoIP providers: It is a fact that voice over IP ("VoIP") application providers like Vonage are now beginning to offer voice applications that compete at the retail level against similar products and services offered by MCI and Verizon, as the California pleading indicates.[8] As with cable telephony, the availability of VoIP service currently is not evidence of actual deployment of the type that would lead to the conclusion that requesting carriers are not impaired without unbundled access to incumbent LEC switching, for the following reasons:

- VoIP rides over and requires a broadband connection; today, only about 21% of U.S. homes have broadband connections.
- When the cost of a broadband connection is factored in, VoIP service is more expensive than most local and long distance packages for traditional calling.
- VoIP for consumers remains subject to a number of quality concerns that make it inferior to wireline service.[9]

Even if most consumers would be willing to accept VoIP as an alternative, there are only two major broadband platforms today that can deliver VoIP service to the mass market – the ILEC and the cable company. As MCI has explained, the resulting market power of this duopoly cannot be dissipated by the existence of so-called independent VoIP providers.[10]

Wireless Providers: It is a fact that wireless carriers offer an undifferentiated product, typically a bundle of minutes for a set monthly price. It is also a fact, as the California pleading points out, that wireless substitution for long distance services has led to substantial erosion of the market share (and revenues) of the traditional wireline long distance providers. The California pleading thus focuses on this problem of wireless substitution. The day may well

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[7] *See* Letter from Donna Lampert and Mark O'Connor, Counsel for EarthLink, to Marlene Dortch, FCC, CC Docket No. 01-338, at 6 (Oct. 12, 2004).

[8] As the California pleading confirms, however, the number of customers taking such offerings is still relatively small, although it is growing.

[9] *See generally* MCI Reply Comments, WC Docket No. 04-313, at 14-25; Dr. Michael Pelcovits & Dr. Ken Baseman, "The Promise of VoIP: Let Them Eat Cake from the Only Two Bakeries in Town," attached to Letter from Curtis L. Groves, MCI, to Marlene H. Dortch, FCC, WC Docket No. 04-313 (Nov. 16, 2004) ("VoIP White Paper").

[10] *See generally* VoIP White Paper at 20-28.

come when wireless also is perceived as a substitute for local, but, as this Commission recently concluded, that day is not here yet for the vast majority of consumers in this country.[11]

The Task Ahead

In accordance with the mandates of the *USTA I* and *USTA II* decisions. The Commission must conduct a granular examination of operational and economic impairment on a market-by-market basis. The ILECs would prefer to have this Commission simply ignore the law, the facts, and these issues, by making broad and ultimately unsubstantiated claims. The court decisions do not afford the Commission that luxury.

At the same time, companies like MCI face significant pressures on the state side. As the California pleading indicated, MCI and similarly situated companies face retail regulation, and a crazy quilt of intercarrier compensation charges. MCI's California pleading is relevant to those matters, but not to the impairment questions under review in this proceeding. Verizon's last-ditch attempt to confuse the issues at hand is at best unhelpful as the Commission continues to undertake the rigorous and granular analysis of impairment that is required by the *USTA I* and *USTA II* decisions.

Sincerely,

/s/ James L. Lewis
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/s/ Richard S. Whitt
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Attachment

cc:	Scott Bergmann	Matthew Brill	Michelle Carey
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11 *Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation For Consent to Transfer Control of Licenses and Authorizations*, WT Docket No. 04-70, Memorandum Opinion and Order ¶ 242 (rel. Oct. 26, 2004) (FCC 04-255) ("substitution between wireless and wireline services is currently limited").

Exhibit 1

Attachment for letter

BEFORE THE PUBLIC UTILITIES COMMISSION OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated.	**Rulemaking 01-09-001 (Filed September 6, 2001)**
Order Instituting Investigation on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated.	**Investigation 01-09-002 (Filed September 6, 2001)**

MCI, INC.'S REPLY COMMENTS ON ASSIGNED COMMISSIONER AND ADMINISTRATIVE LAW JUDGE'S RULING INVITING COMMENTS REGARDING THE SCOPE AND SCHEDULE OF PHASES 3A AND 3B

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Dated: November 15, 2004

MCI, Inc. ("MCI") respectfully submits these reply comments to the opening comments filed in response to the Assigned Commissioner and Administrative Law Judge's Ruling Inviting Comments Regarding the Scope and Schedule of Phases 3A and 3B of the above-referenced proceeding, dated October 15, 2004 ("Ruling").

I. INTRODUCTION

In their opening comments, the ILECs have asked for "a fundamental reform of telecommunications regulation in California." MCI, as well, commented that recent technological, regulatory, and market changes require a fundamental reevaluation of retail regulation of traditional wireline telecommunications firms. Where market conditions justify, such as in the retail market, regulation should be relaxed or eliminated, both for the ILECs and for competitive local exchange carriers. But deregulation where deregulation is merited must go hand in hand with continued regulation where monopoly conditions persist, in wholesale markets such as for unbundled network elements and switched access.

The ILECs opening comments, however, fail to even mention, much less place appropriate emphasis on, the need to engage in regulatory reform of both the *benefits and burdens* of the current regulatory paradigm in order to truly level the playing field. It seems they want to have their cake and eat it too. They want deregulation on the retail side but want the guaranteed revenue streams that current regulations provide, such as the current intrastate switched access charge regime. The Commission should recognize market developments and free the ILECs from the unnecessary burdens of retail regulation, but only if it at the same time it eliminates the benefits of regulation that are no longer warranted and afford the ILECs unequal protection and competitive advantage.

This means that any ILEC deregulation should be tied to a reduction in switched access charges to cost based levels. Further, as MCI set out in its opening comments retail deregulation should apply equally to all wireline carriers, ILECs and competitive local exchange carriers alike.

II. THE SCOPE OF THIS PROCEEDING NEEDS TO BE BROADENED AND MADE FLEXIBLE ENOUGH TO FUNDAMENTALLY REEVALUATE THE COMMISSION'S CURRENT RETAIL REGULATION OF *ALL* TRADITIONAL WIRELINE CARRIERS.

SBC California's opening comments recite the dramatic and rapid development of nontraditional communications technologies and firms which have altered the telecommunications marketplace[1] and require the Commission to start from a "clean slate" and examine "a fundamental reformation of telecommunications regulation in California."[2] Verizon California follows suit,[3] urging the Commission to jettison "the "individual laundry list of issues dating back to the last NRF review" and look ahead to "California's next generation telecommunications regulatory framework."[4] Both incumbent local exchange carriers ("ILECs") basically recommend that the Commission commence a policy phase of broad and flexible scope to examine a complete overhaul of the "New Regulatory Framework."[5] MCI, as it set out in its opening comments, fundamentally agrees with the ILECs that recent technological, regulatory and market changes justify an expansion of the scope of Phase 3 of this NRF proceeding. MCI has

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[1] SBC CA's Opening Comments at 4-11.
[2] Id. at 2 and 4.
[3] Verizon CA's Opening Comments at 6-9. MCI does not necessarily agree with all the claims, facts and figures regarding intermodal competition presented by the ILECs and the particular significance the ILECs give them, but we fundamentally agree they justify a reevaluation of retail regulation of traditional wireline carriers. We reserve the right in our future, substantive comments to further address the facts and the significance of intermodal competition.
[4] Id. at 1.
[5] Verizon Opening Comments at 4-5; SBC California's Opening Comments at 15-16.

recommended a set of questions in Section II of its opening comments that it believes covers the waterfront of current regulatory requirements that generally apply only to traditional wireline telecommunications firms and seriously disadvantage them relative to new communications technologies and firms.

The incumbent local exchange carriers' recommendations and the rationale they set forth for broadening the scope of Phase 3 of NRF apply with equal force to the regulatory requirements currently applicable to MCI and all other traditional wireline carriers. The advent of nontraditional communications technologies and firms affects MCI as well as the ILECs and MCI is competitively disadvantaged by the heavy-handed utility-like regulation to which it and other traditional wireline carriers are subjected. If a broader scope is adopted for Phase 3 as it should consistent with the ILECs' recommendations, then regulatory issues applicable to nondominant traditional wireline carriers, such as MCI, clearly can and should be accommodated at the same time. In fact, no other approach makes any sense whatsoever, since a broad and flexible scope for Phase 3 to consider fundamental regulatory reform as advocated by the ILECs would of necessity at a minimum cover the same set of issues as they apply to similarly situated nondominant telecommunications carriers.

MCI agrees that the overarching policy objective of the Commission's reform of its regulatory framework should be to promote competition and establish "regulatory symmetry among competing carriers"[6] in *retail* markets.[7] To the extent the ILECs'

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[6] SBC Pacific Opening Comments at 14.

[7] Because this proceeding focuses on the regulation of retail services and the ILECs' participation in retail markets, MCI does not address here issues relating to the regulation of the wholesale provision of ILEC services and facilities, such as interconnection, resale and unbundling under Sections 251 and 252 of the Telecommunications Act of 1996. Regulation of the ILECs' wholesale services and facilities designed to constrain, mitigate or overcome the ILECs' monopoly control over local bottleneck facilities and regulation

comments would restrict the reevaluation and reform of the current regulatory paradigm to consider only its impact on and relief for "incumbent" carriers,[8] regulatory symmetry can not be accomplished. There is no justification for such a myopic approach. MCI urges the Commission that the scope of phase 3 of this proceeding is sufficiently broad to include directly related issues concerning current regulation of nondominant wireline telecommunications carriers. It should reject a lopsided and counterproductive limitation of the scope of Phase 3 to incumbent carriers and instead consider level playing field issues for all traditional wireline carriers.

III. THE ILECS GLOSS OVER THE NEED TO ELIMINATE INFLATED ACCESS CHARGES AND REFORM ALL FORMS OF INTERCARRIER COMPENSATION TO LEVEL THE PLAYING FIELD AS PART OF ANY PROGRESSIVE, RATIONAL REGULATORY REFORM.

The ILECs' Opening Comments notably omit any mention of the need to rid the marketplace of the distortions caused by the inflated access charges they are permitted to levy against their wireline competitors. SBC California blithely mentions in passing that "[m]any consumers are shifting long distance calls to their wireless calling plan,"[9] while failing to acknowledge that SBC California has perpetuated a scheme of non-cost based access charges which cripple competition from wireline long distance carriers. While SBC California bemoans the shifting of long distance traffic to wireless carriers, it fails to acknowledge that this shift has occurred in no small part because the ILECs insist on an

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to prevent ILECs from engaging in anticompetitive conduct where it continues to possess market dominance is still required and, in fact, should be the focus of reformed regulation.

[8] See for example, Verizon Opening Comments at 2-3: "The overarching policy issue would be to determine how *incumbent providers* should be regulated in the future dynamic and changing marketplace." (emphasis supplied)

[9] SBC California Opening Comments at 5.

entitlement to inflated access charges allegedly to "subsidize" local service and thereby maintain "revenue neutrality" borne of historic rate base rate-of-return regulation. MCI agrees with SBC California that the Commission should "avoid the trap of a regulatory approach that..., at worst, ... protects competitors at the expense of efficient and beneficial competition."[10] There could be no more appropriate example of the vestiges of such a harmful approach than the maintenance of inflated access charges to protect the ILECs' revenue streams. Consistent with MCI's opening comments, the Commission should ensure that while it considers granting the ILECs relief from the burdens of regulation it eliminates this anticompetitive and market distorting benefit bestowed on the ILECs as well. Traditional wireline long distance competitors, such as MCI, suffer disproportionately from this relic of protectionist rate base regulation while wireless carriers and emerging technologies, such as VoIP, pay much lower charges to terminate calls to ILEC customers.

MCI agrees with the position of the Office of Ratepayer Advocates ("ORA") that access charge reform issues are directly related to Phase 3 of NRF[11] and strongly urges the Commission to resolve the access charge issues pending in R.03-08-018 before it issues any decision relieving the ILECs of the burdens of the NRF. Access charges must be moved to economic cost, with the first step to eliminate the admittedly not cost-based NIC and TIC, in order to remove the crippling impact inflated access charges have on the ILECs' wireline long distance competitors. The Commission should go on to consider all

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[10] SBC California Opening Comments at 4.

[11] ORA Opening Comments at 3-4. MCI also concurs in ORA's sound suggestion that price floor issues be determined at least initially in the already pending proceeding where those issues are already being addressed, A.04-03-035. There is no reason to duplicate that effort here. A Proposed Decision has already been issued in that case and the parties' comments on the proposed decision have been submitted. The Commission can consider issues related to price floors other than those determined in A.04-03-035 in Phase 3 of NRF, but it should not permit review of the issues that will be determined in A.04-03-035. Review of the same issues in Phase 3 would be duplicative and a waste of Commission time and resources.

aspects of intercarrier compensation within its jurisdiction, with the objective of rationalizing and unitizing the existing disparate intercarrier compensation schemes eliminating the distortions they cause in a marketplace where wireline carriers that compete with the ILECs must also compete with wireless services and other emerging nontraditional technologies that do not bear the burden of inflated access charges.

SBC California also hints at the need to reconsider universal service policies and programs as a part of the NRF review.[12] MCI agrees that the Commission should at least consider in Phase 3 those aspects of its current universal service policies and programs and their administration that are not competitively neutral and hamper the development of competition. In a concurrent proceeding, the Commission should take a close look at the current justification for the billions of dollars in subsidies received by the ILECs in the name of universal service using more up-to-date Commission-approved forward-looking cost studies. It should also reexamine the goals of and definition of universal service with a focus on assisting customers that need help, not propping up select competitors, such as the ILECs, to the disadvantage of others.

IV. THE OPENING COMMENTS OF ORA, TURN AND COX FAIL TO RECOGNIZE THE PROFOUND TECHNOLOGICAL, REGULATORY AND MARKET DEVELOPMENTS WHICH HAVE TRANSFORMED THE INDUSTRY AND MAKE THE CURRENT REGIME OF RETAIL REGULATION HARMFUL AND OBSOLETE.

Cox California Telecom, L.L.C.'s ("Cox's") motives for perpetuating the old regulatory regime which disproportionately burdens traditional wireline carriers to its and other cable companies' advantage is questionably selfish. ORA and TURN, however, no doubt are motivated by a desire to protect consumers. But outmoded retail regulation no

[12] At 8, fn 29, and 14, the last bullet item.

longer serves this purpose. The key to forward-looking progressive regulation is to level the playing field to promote competition, not just between traditional wireline carriers, but between traditional wireline carriers and the new communications technologies and firms that have appeared in the marketplace and are unfettered by the old regulatory regime. Consumers will not benefit if traditional wireline telecommunications firms are artificially hampered and disadvantaged in the marketplace relative to new communications technologies.

MCI does not dispute that the ILECs retain undisputed market dominance over traditional wireline local exchange and exchange access services and, furthermore, that they are extending that dominance to traditional wireline long distance services and digital subscriber line services. Nor does MCI dispute that intramodal competition for wireline local exchange and exchange access services largely occurs today because the Telecommunications Act of 1996 requires that the ILECs provide interconnection and nondiscriminatory access to their local exchange and exchange access networks on an unbundled basis at forward-looking economic cost.[13] But the solution to the problem of ILEC dominance over wireline local exchange and exchange access services is not to strangle the ILECs' wireline competitors with unnecessary, unequal and outmoded traditional utility retail regulatory requirements.

Regulators need to vigorously enforce the interconnection, unbundling, and resale requirements of the Telecommunications Act of 1996, enable and encourage intramodal competition. In order to do so, however, regulators need not continue to burden the ILECs' wireline competitors with unequal, crippling and outmoded retail regulation that

[13] ORA Opening Comments at 2-3; Cox Opening Comments at 3-4; TURN Opening Comments at

disadvantages them relative to nontraditional communications technologies and firms. In areas where competitive forces have not taken hold and are not on the horizon – particularly in wholesale inputs in which the ILECs maintain monopoly or near-monopoly control – regulation remains necessary to constrain the ILECs' market power. But there are significant challenges ahead for state commissions as the industry completes the transition to a competitive and largely unregulated field. This week's important ruling by the Federal Communications Commission (FCC) regarding Vonage's Voice Over Internet Protocol (VoIP) service is an excellent example of the need to overhaul completely our thinking about how communication services should be regulated… or not regulated…as the case may be. This ruling by the FCC and the expressed intent of the FCC to foster intermodal competition, calls for state regulators to approach the regulation of telecommunications or telecommunications-like services in a new way.[14]

Technology and markets are evolving more rapidly than anybody would have anticipated only a few years ago. Broadband investment occurred and we are now beginning to see the results of that investment in the form of various fiber to the home initiatives (both public and private), BPL, wireless, Wi-Max and various cable offerings. The impact of the "broadband revolution" is the convergence of voice and data, and the most immediate, but by no means the last, manifestation of that convergence is voice over internet protocol (VoIP). Although the impact on many companies of these "disruptive technologies" has been painful, it has also forced all of us to take a hard look

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[14] See *Re Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, **MEMORANDUM OPINION AND ORDER**, WC Docket No. 03-211, FCC-04-267, (released Nov. 12, 2004).

at the regulatory environment in which we serve consumers and begin the difficult job of determining whether the frameworks of the past fit the world of the future.

Simply put, convergence means that telecommunications can no longer be thought of as a traditional, state regulated utility any more. Attempts to keep such regulation on "traditional providers" such as MCI or the ILECs simply skew the market place by creating an asymmetry of regulation.

V. CONCLUSION

For all the reasons addressed in these and MCI's opening comments, the Commission should broaden the scope of Phase 3 consistent with MCI's recommendations and add the specific questions set out in Section II of MCI's Opening Comments to the scope of this proceeding. The Commission should also move ahead quickly to reduce intrastate access charges as soon as possible, at least concurrently with this proceeding, examine and reform current disparate intercarrier compensation schemes within its jurisdiction, and reexamine its universal service policies, programs, and existing subsidies.

Respectfully submitted,

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November 15, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have on this day served a copy of the

MCI, INC.'S REPLY COMMENTS ON ASSIGNED COMMISSIONER AND ADMINISTRATIVE LAW JUDGE'S RULING INVITING COMMENTS REGARDING THE SCOPE AND SCHEDULE OF PHASES 3A AND 3B

on all parties to R.01.09.001 by mailing a properly addressed copy by first-class mail with postage prepaid to each party named in the official service list.

Executed on November 15, 2004 at San Francisco, California.

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